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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Annual Compliance Report **Docket No. ACR2008**

Initial Comments of the American Catalog Mailers Association

In accordance with the Notice issued by the Postal Regulatory Commission (Commission or PRC) on December 31, 2008, soliciting public comment on the Postal Service's December 29, 2008, Annual Compliance Report (ACR) for Fiscal Year (FY) 2008, the American Catalog Mailers Association (ACMA) hereby submits the following Initial Comments:

1. The ACMA is a trade association of catalog companies and their key suppliers that use the mail to solicit orders or to gather new customers. There were an estimated 20 billion catalogs delivered by the US Postal Service (USPS) in 2006 and catalogers are also originators of letter-shaped mail both in First-Class Mail and Standard Mail, as well as a large number of packages sent via a variety of delivery services including the USPS. ACMA members are multi-channel merchants that may also operate retail stores, advertise in a variety of other media, operate extensive websites or aggressively pursue eCommerce activities. Despite the wide use of various media in their operations, catalogs sent through the mail remain currently the mainstay of cataloger marketing contact. The choice of media is directly related to its market effectiveness, a calculation that takes into account (a) the cost of that media and (b) the revenue generated via that media, often measured by response rate and order volume.

Postage paid to the USPS by catalog companies to mail catalogs and other advertising materials represents one of the highest distinct cost centers for catalogers. Postage cost often ranges between 15% and 20% of total sales for business to consumer (B2C) catalogers, and 5% to 12% of sales for business to business (B2B) catalogers; some members report that when in a growth mode postage cost as a percent of total net sales can exceed 30%[1]. Given the high proportion that postage represents to their total cost mix, catalog companies are very sensitive to changes in postage rates.

Catalog companies are highly dependent on mail as it has historically been the foundation media for their business models[2]. While catalog companies are devoting a great deal of effort in attempts to change this, the quality of mail responses still remains high compared to those of other channels. Since catalogers rely heavily on the USPS and since postage spending is a very significant driver of catalog company profitability, postal cost increases resulting from the R2006-1 rate case has created widespread disarray by altering fundamentally the economics of catalog marketing. Increased costs associated with the implementation of R2006-1 has caused many catalogers to redeploy their marketing expenditures to de-emphasize mail in favor of other media substitutes, leading to a sharply decreased mail volume[3]. This effort is ongoing. Many catalogers report strategic initiatives to reduce their dependence on mail by thirty and event thirty-five percent per year for the next five years. An interesting contrast to the intent of PAEA, non-ACMA catalogers often view postage costs as not subject to market forces, uncontrollable and unpredictable, and have little interest in engaging to understand how postal policy is formulated or can be addressed. It is simply easier to focus on alternatives. For these reasons, ACMA forecasts a continued reduction in catalog-generated mail volume for the foreseeable future unless action is taken to change the *status quo*. The simple reality is that if market effectiveness of mail does not improve for catalogers, the use of mail will continue to decline at an increasing pace as catalogers perfect other contact strategies.

Compounding the R2006-1 rate case impact is a widespread recession with depressed consumer confidence and retail spending, combined also with a general lack of commercial credit availability necessary to finance the purchase

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[1] Based on ACMA interviews with members, 2007-8.
[2] See, among others, the UPM North American Multichannel Marketing Report, 2007, page 15 or survey recent issues of catalog trade publications (such as Catalog Success or Multi-Channel Merchant).
[3] See item 2 below.

of both inventory and postage prior to revenue realization. Both the recession and the commercial banking environment have placed a significant strain on catalog mailers. In 2006, the catalog industry was estimated to have generated $270 billion in economic activity. Cataloging represents nearly 2% of US Gross Domestic Product (GDP)[4] in an economy hungry for end consumer demand. In addition to the migration away from mail, the impact of sharply higher mailing costs combined with current economic conditions has translated into widespread catalog industry layoffs and downsizing, reduced industry equity values and stock prices, depressed sales multiples, changes in ownership control often at "firesale" prices, management turnover in both catalog companies and their suppliers, decisions to discontinue catalog operations altogether, and other symptoms of economic turmoil.

This widespread instability affects all companies. Catalogers may often rent or exchange names with other catalogers; thus, volume declines by one cataloger impacts the availability of potential customers to other catalogers. The entire industry (and postal volume) suffers when there is a general reduction in the number of names that can be mailed. This effect is noted in the sharp reductions of "twelve month counts," or the number of names on each cataloger's house file that have ordered in the past year, the single greatest measure of catalog economic health. Since twelve month customers are the ones that receive virtually every mailing of a cataloger and are also the ones that are most desired by other catalogers to prospect, persistent declines in twelve month counts across the industry is a troubling signal of future volume erosion in this segment of the mailing industry.

Today, catalog executives report the industry is on a persistent downward spiral. While general economic conditions may be expected to reverse, comparative mail volumes versus substitute media choices are not. Given the

[4] Based on ACMA estimates drawn from a variety of sources. This figure includes direct commercial activity including upstream and downstream economic value added suppliers and includes eCommerce revenues generated by catalog companies. It does not include retail sales from companies that may also publish a catalog or revenue from retailers that do not use catalogs as a key component of their marketing mix. For instance, the direct sales by cataloger Williams-Sonoma would be included but volume from Nordstrom, who may occasionally publish a catalog, is not included.

fundamental change to catalog mailing economics as of 2007, the outlook for catalog mail volumes is bleak even after a return to better economic conditions. Unlike other mail that is impacted by external factors beyond the control of policy makers, many of the factors affecting catalog-originated mail volumes are within the control of the mailing industry and policy makers. In fact, had catalogs received their *pro rata* share of automation investment and policy attention in the past that other types of mail have received, other than depressed volumes caused by the recession, catalog volumes would not be in a downward spiral of declining volume today. The situation is reversible. Proper attention to this sector to address the issues outline herein will go a long way to keeping catalogs in the mail for generations.

2. Unlike some other sectors, the Catalog industry volume expands (i.e. spiral up) or contracts (i.e. spiral down) in mutually reinforcing loop. Expansion and contraction are due to a variety of factors with postage cost being one of the more important. Information ACMA is receiving on the expectations for mail volume is born out in the fourth quarter FY 2008 USPS Revenue, Pieces & Weight (RPW) Report for the two primary products that catalog companies utilize for catalog mailing. The RPW indicates that volume in catalog-dominated service categories was dropping even before the recession took hold. Standard Mail flats is down 23% and Standard Mail Carrier Route (CR) flats is down 22%. ACMA expects this decline to continue and accelerate. While general economic conditions will depress catalog volumes further from those documented in the FY2008 RPW and are outside the control of anyone, the significant migration of marketing expenditures away from mail created by the implementation of a new pricing regime in May 2007, is more controllable and can even be reversed with proper management.

Visibility of future rate changes is an important factor to allow catalogers to maintain mail volumes in the face of increasing rates. The R2006-1 rate change hit catalogers wholly by surprise; they are still reeling from the “rate shock.” The lack of time to prepare and adjust business plans to accommodate such high cost increases did additional damage to both cataloger profitability and catalog mail volumes. When catalogers expect postage costs to increase, they begin a variety of tests of mailpiece design, marketing offers and merchandise assortment. The goal is to find a factor, or combination of factors, that will improve the marketing effectiveness to support a more expensive mailpiece without cutting mail volume. A mantra historically heard in the industry is "catalogs in the mail equals sales." Using known controls, catalogers painstakingly measure the effectiveness of a new approach, isolating one variable at a time. These tests are segmented so that catalogers reduce the risk of wholesale changes to their mail pan and market offer. They seek to avoid the additional risks endured when untested changes are made to an entire mailing.

Catalogers are highly sensitive to the total cost of reaching their audience and are able to calculate a breakeven for each mailing. In fact, given the known ordering pattern of customer lists, and the gross margin and order size expectations of the current offer, catalogers typically mail as deep into their house files (i.e. customer lists) as possible until breakeven is reached. To cite a simplistic example, best customers order more dollars and do so more frequently than marginal customers. Catalogers will typically mail first to all of their best customers in a mailing, then continue to work their way down a stratified customer list until the expected gross margin dollars generated from that customer segment equals the total cost of reaching that segment. Total cost is the printing, paper and mailing cost of the catalog. As costs go up, the number of customers that can be profitably reached through the mail declines.

Prospect activity is similarly allocated. A catalog company's cash flow, capital structure and growth aspirations usually dictate the amount of prospect investment that can be made in each period. These dollars are then allocated among media channels The amount allocated to mail drives the amount of prospect mail volume included in each mail drop. Thus, the cost per prospect (of which postage is typically 35% to 50% of this total and drives the number of additional catalogs added to the house file catalog production order. In normal times, this can amount to as much as 60% of the total mailing making prospecting activity a substantial portion of total catalog mail volume.

Prospect mailing is a long-term investment by a cataloger in its the future. Prospecting activity seldom breaks even in a single mailing. Put another way, the cost of acquiring a customer is not expected to be recouped from orders gathered in that the prospect mailing. A cataloger must look at the Lifetime Customer Value (LCV) to assess what the likely value of a prospect conversion will be over time. To restate the impact described above in another way, the number of new consumers or businesses a cataloger prospects in each mailing is a result of the amount of money they can afford to invest in growth, the expected LCV and the total cost per book to reach the audience. Since postage can be half of this cost per book, higher postage results in fewer prospect books mailed each mail drop. It also carries a high opportunity cost to the Postal Service. Once prospects are converted to buyers, they then receive nearly all subsequent mailings from that cataloger thus creating a significant multiple effect.

Amplifying the impact of media choice for prospecting to total cataloger mail volume is the reality that catalogers tend to return to that successful media channel in all subsequent communications to customers. Customers who have demonstrated the propensity to respond to email when being prospected will tend to get emails in subsequent order gathering activity. Those that respond to mail offers as prospects will tend to get future mailings through the postal network. Much like Apple Computer gives schools free computers for classroom use in the hope an emerging consumer with a high LCV develops a preference for Apple brand personal computers, the USPS can secure future mail volume by keeping mail *the* favored channel for prospecting activity. Prospecting via mail is a strategic leverage point. It can be quickly adjusted by catalogers given its minimal impact on inventory levels but it is the harbinger of future mail volume.

3. The profitability to the USPS from catalogs may not be well understood. ACMA recognizes that, as indicated in the ACR, specific costs of particular products may not yet be fully defined; the US Postal Service cautions ACR readers to recognize the preliminary nature of some cost conclusions. Since catalogers have not historically had a dedicated intervener in litigated rate cases,

and with that the ability to provide input to methodologies for cost attribution developed over decades, the cost for mailing catalogs may not be as well documented as in other types of mail. In any case, rate structures have not benefited from participation of the most informed party that has direct knowledge of pre- and post-mail processes.

ACMA also notes that the ACR for FY 2008 indicates that Standard Mail flats average revenue does not cover average attributable cost. This is the first year this information has been broken out in this form so there is not accurate historical comparison as to how much costs have increased in the past year. However, In light of the large volume declines and the high fixed costs ascribed to all mail, it is logical to conclude that volume degradation has been a significant driver of higher attributable costs for catalogers. Catalogs are, in effect, penalized twice as a spiraling down triggered by R2006-1 takes hold. Add to this the fact that catalog-type mail has not benefited from significant capital investment to automate mail that greatly reduces its processing cost; catalogers are again penalized via their attributable costs. Catalogers must bear the higher cost of manual processing. Finally, as is described below, cataloger-type mail is used as “shop fill” providing manual work during slack processing times in plants. Here again, the owners of this type or mail are being penalized by being held responsible for the allocation of previously unallocated work hours. The compounding impact represents a “quadruple whammy” on catalog cost structure that is totally outside the control of catalog mailers. This seems neither fair nor equitable. It is more an affect of historical postal policy and operational choices made than the nature of the specific item mailed. Certainly catalogers can be faulted for not participating in the historical dialog that gave rise to this situation but enough mitigating circumstances are present with the benefit of hindsight to indicate that a different approach to this mailer segment is required under the circumstances.

4. Information conveyed to ACMA in anticipation of R2006-1 litigation suggests catalogs then provided institutional cost coverage approximating 56%. As far as we know, definitive data on cataloger contribution to institutional costs

has never been entered on the record. Despite requests from some other Standard Mail interests for greater cost coverage from catalogs, most observers generally believe catalogs have been a profitable segment of mail for the USPS. Whatever the appropriate cost coverage from catalogs, the magnitude of the R2006-1 change and the lack of visibility by catalogers that a change of this magnitude was expected, created material economic hardship to such a degree that catalog companies began to curtail their future mail volume plans. As catalogers must maintain a forward commitment to inventory and production, substantial changes in mail volume could not be made by most catalogers until calendar 2008. Since some proportion of USPS catalog mail costs are fixed, the dramatic volume degradation certainly must have affected the data upon which the USPS determines catalog processing and delivery costs. What is more, while other types of mail have enjoyed the results of the USPS' substantial investment in automation to reduce the direct cost of its handling, flat-shaped mail has not historically been the beneficiary of this capital investment. Were it highly automated, arguably, the cost to handle catalogs and other flats would be much less today.

Discussions with USPS operations personnel have indicated that catalog processing is still highly manual and flats are often being used as "station fill" to buffer slack work periods. Plant managers are understandably concerned about the impact on morale and operating efficiency when sending USPS employees home should low volumes not require a full staffing complement. It is not uncommon to deploy otherwise idle workers to manual flats processing to fill in gaps. The USPS recently allocated nearly a million previously unallocated work hours; flats reportedly received a large share of this allocation. While ACMA does not have the data to contest this allocation nor the wherewithal to compel the release of the specific methodology driving the allocation process, it must be noted that had flats received the same amount of automation expenditure at the time other mail was automated, the degradation of attributable cost from this allocation would be irrelevant. In other words, flats are paying a double penalty given the history and the deferrable nature of their type of mail.

Catalogers suspect the higher costs of Standard Mail flats is being driven significantly by (i) reduced catalog volumes and (ii) significant allocation of previously unallocated work hours accruing from its use to level load work, keep plant employees engaged and the lack of historical investment in automating this type of mail.

5) While the cost side argument may be interesting to longtime postal observers, it does not reflect the realities of the market place. The issues are almost as simple as determining whether the USPS wants to be in the catalog business at all. If the answer is affirmative, then the USPS and catalog industry need to partner to remove costs, automate mail flow and find ways to further increase the value of mailed catalogs so that the sector continues to grow producing a greater and greater profit for both the USPS and catalog companies. Given that there is a substantial corpus of catalog volume (estimated to be 20 billion pieces in 2006) in the system now, a long history of mailers loyal to the USPS who mail every day of every week, and substantial positive impact on the value of mail to the recipient generated by catalogs, this customer sector seems an attractive one for the volume starved USPS. Catalogers understand fully the concept of lowest total cost and how to take costs out of a supply chain. Catalogers have a long history of re-engineering in partnership with complex supply chain partners. Yet historically, catalog companies have not partnered with the USPS to optimize catalog delivery and processing costs.

Demographic trends in cataloging favor continued growth of industry mail volume as baby boomers are already heavy consumers of catalog merchandise, and catalog utilization tends to increase with advancing age. Unlike other mailers who have significant economic incentives to reduce mail, catalogers remain committed to the method of marketing distribution that has served them so well for over a hundred years. Catalogers readily realize the unique advantage offered by hardcopy delivery via the USPS. Since Congress has made it clear it expects the USPS to move to more market-based rates in the future, it seems logical for those involved in postal policy to encourage this group of postal customers to stay in the mail, improve the economics of their operation, and continue to provide desired content value to a system that must compete with substitutes such as the Internet that are free and immediate or those that clearly compete with the USPS for advertising or transportation spending such as print media and package delivery services. Driving catalogers out of the system does not seem in the best interests of anyone.

6. Catalogs provide substantial societal benefits unavailable elsewhere. Catalogs are the single source of goods and services to shut-ins and those who are physically impaired or who cannot easily arrange transportation. Catalogs provide a wealth of products and services to rural Americans without ready access to well developed retail shopping areas. Catalogs fill a need for time-starved dual income households and single-parent households that find it difficult to shop in traditional retail outlets by virtue of their personal schedules. The "always available" nature of catalogs allows shopping from home at a time most convenient to the buyer. Catalogs provide businesses with necessary merchandise not generally available in the general market. Catalogs provide a breadth of product alternatives not always found in traditional outlets and give smaller manufacturers, distributors, inventors, and importers access to the American mass market without the cost and requirements necessary to sell national retail chains. Providing an entrepreneurial opportunity, the catalog industry has historically been a successful vehicle for private wealth building. Though its numbers are getting smaller as a result of the economic disarray it faces today, the catalog industry remains a substantial employer of Americans. Arguably, catalog shopping has a lower environmentally impact than some alternatives as the shared ride into the home reduces the need for individual shopping trips even when the ultimate purchase is made from a physical retail location. Contrary to popular belief, the Internet has been a boon to cataloging. Once catalog companies learned how to combine the advantages of web-based and hard copy communications, they have found the wholly symbiotic, mutually-reinforcing relationship between "clicks, bricks and books."

CONCLUSION

The catalog industry is imperiled today. For the foregoing reasons, and in consideration to the many benefits of catalogs to (a) the USPS, (b) mailers who do not want to see any substantial volume leave the system unnecessarily, and (c) to America generally who needs stronger consumer consumption to overcome a recessionary malaise, employment for its workers and wealth creation that generates its tax receipts, the catalog industry requires a fresh approach by postal decision makers. Absent immediate work to address the issues raised here, ACMA believes the future for catalogs in the mail is bleak. Unlike migration of other types of mail out of the postal system, this outcome is generally within the control of postal policy makers. Beyond current economic conditions that can be expected to be limited to some finite duration, there is no macro economic or technology driver depressing catalog mail volumes other than the cost of accessing the mail most dramatically illustrated by a quick change to rates or more insidiously caused by onerous postal requirements. Addressing these is beyond the ability of a nascent association supported by a handful of companies. The economic harm of the past year and a half makes it difficult to organize a fragmented industry that does not have any history of cross-company collaboration, let alone a long history of participating in the national postal policy debate.

Today, mail-based alternatives are few, while non-mail media is becoming ever more attractive. The USPS presently enjoys an edge. Mail respondents still demonstrate a higher quality lifetime customer value (LCV) and exhibit better Recency, Frequency and Monetary Value (RFM) for catalogers than non-mail alternatives. However, this edge is fleeting. A tremendous amount of effort is underway within the catalog industry to improve further the efficacy of non-mail media. Just as it took catalogers a period of years to discover optimum methods to utilize the Internet, one can assume it is only a period of time before catalogers unlock the secrets that make non-mail respondents as productive as mail-borne responses. Given that a marketing effectiveness calculation accounts for both cost and revenue, the hurdle for “mostly free” media such as email is low. It may be that the best strategic interest of the USPS is to remove a powerful stimulus for the development of non-mail alternatives by adjusting immediately those factors driving long-term demand elsewhere. ACMA believes an immediate and intense effort must be made to resolve the basic barriers of mail use by catalogers, as they represent a very high LCV for the USPS and a loyal consumer of USPS services with a substantial “installed base of users” and deployed business processes developed over decades that generate significant volumes of mail while adding measurably to the consumer experience of receiving mail.

Respectfully submitted,

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